

Cautious Steps on Inverse, Leveraged ETFs in HK

Hong Kong's Security and Futures Commission (SFC) finally released rules on leveraged and inverse exchange-traded funds (ETFs) in early February, more than a year after these products were permitted in Taiwan.

The asset management industry in Hong Kong is likely to cheer the announcement as it opens up room for product variety and innovation in the Hong Kong ETF space. A lack of product variety, which deters retail participation, has long been the main gripe of industry players in Hong Kong. Hong Kong's ETF market draws only 10% of its assets from retail investors, and most of the turnover is in just two ETFs, namely iShares FTSE A50 China and the CSOP FTSE China A50.

Leveraged and inverse ETFs have long been popular in Japan and Korea, and most recently in Taiwan. Chinese managers are interested in launching these products too. Some managers have reportedly been waiting for regulatory approval from the Chinese regulator for as long as 20 months, but industry practitioners doubt the nod will come any time soon.

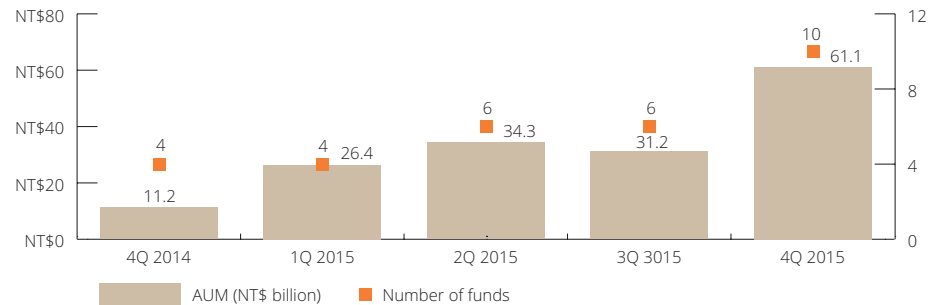
In SFC's circular released in February, it said that only "liquid, broad-based non-Hong Kong, non-Mainland foreign equity indices" are allowed to be tracked for a start. Liquid, broad-based Hong Kong indices may be allowed after the regulator's review after the first batch of products has been launched, expected in the third quarter of 2016. Mainland indices were left out in the February circular.

Taiwan buzzing

Judging by the flurry of leveraged and inverse ETF launches in Taiwan after gain-

Leveraged and Inverse Exchange-traded Funds in Taiwan, 2014–2015

Sources: Securities & Investment Trust Consulting Association, Cerulli Associates



ing approval in October 2014, Cerulli expects Hong Kong to follow the same trajectory. As of January 28, there were 39 ETFs listed on the Taiwan Stock Exchange, including 12 leveraged and inverse ETFs tracking the Taiwan 50, SSE 180, CSI 300, Topix, S&P 500 and Hang Seng indices.

There are more products in the pipeline. Fubon Asset Management reportedly filed a pair of leveraged and inverse ETFs linked to Nasdaq 100 and India's Nifty in January and March, respectively. Cathay SIT has also filed for a pair of ETFs linked to the Nikkei-225, while Capital SITC is applying for a pair of ETFs linked to China's CSI 100 index.

The introduction of leveraged and inverse ETFs boosted the daily average trading volume of ETFs in Taiwan by 45% to 299.5 million units between end-2014 and end-2015, according to a research report released by the Taiwan Stock Exchange. Hong Kong will most likely experience a similar surge in trading activity in 2016 as these products go to market later in the year.

Regional or smaller Hong Kong-based asset management companies are expected to be the ones keen to develop the ETF market. The Hong Kong entities of Korean

asset management giants, Samsung and Mirae, have reportedly expressed interest to bring over their expertise from their home markets into the Hong Kong market. Spokespersons from both firms told the media that they are keen to launch innovative ETFs that have done well in Korea. Enhanced Investment Products (EIP), a Hong Kong manager which is 49%-owned by CLSA, has also expressed interest in leveraged and inverse ETFs.

However, it will take time for retail investors to be conversant with these products, and retail participation in the ETF may not have much momentum initially. The SFC itself has shown its sense of caution by stating that leveraged and inverse ETFs cannot be called "ETFs". Instead they must be named as "leveraged products" or "inverse products". In the meantime, the Taiwan ETF market remains ahead of the curve compared to Hong Kong and will set the pace going forward. The Taiwanese regulator gave preliminary approval for leveraged and inverse ETFs linked to futures in January this year and will be planning to dual-currency ETFs as well. Hong Kong's ETF market will have some catching up to do in 2016 and beyond.

- Shu Mei Chua